Overview of the Russian and CIS automotive industry

March 2019
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Russia’s market of passenger cars and light commercial vehicles (LCVs) grew by 12.8% in 2018 on the back of pent-up demand and government support that remained in place under some programs. Contributing factors also included an anticipated rise in the VAT rate and car prices in 2019, as well as expectations of new economic restrictions.

The growth is projected to slow down in 2019, as a fall in oil prices may weaken the Russian ruble. At the same time, Russia’s market still has substantial growth potential in the long term due to the lower size of car park per capita compared with Western countries.

EY presents an analysis of current trends in the automotive market in Russia and other CIS countries and its growth prospects. Growth is projected to continue under a baseline scenario. The readiness of international players to invest in localization projects and the considerable export potential of Russian-made cars and automotive parts may propel the sustainable development of the industry. Transparent and efficient government policy is important to drive localization projects and demand for cars from end-buyers, along with new government incentives for industry investors.

EY professionals will be glad to share their market expertise and assist you in meeting your business needs and identifying investment opportunities as well as provide risk, operational and cost management advisory services.
After the slowing of sales in 2013-16 against a backdrop of general macroeconomic decline, the market began recovery in 2017. The growth accelerated to 12.8% in 2018 and a total of 1.8 mln passenger cars and light commercial vehicles (LCVs) were sold. According to EY forecasts, sales will continue this upward trend, passing the two million mark by 2021.
1. Russia’s automotive market continued to recover in 2018, growing by 12.8%. A total of 1.8 million passenger cars and LCVs were sold.

2. The growth is projected to slow down in 2019, as a fall in oil prices may weaken the Russian ruble. Sales of LCVs dropped year-on-year in the fourth quarter of 2018. This means that sales of passenger cars may also go down in the short run under a negative scenario, as they usually follow the same cycles as the LCV market with a time lag.

3. We believe that the Russian market has a significant potential in the long run due to low size of car park per capita, the ageing car park and the rise of automakers’ captive banks.

4. The growth recovery rate is conditional on macroeconomic factors such as the strength of the Russian ruble, inflation, auto loan interest rates and government regulation of the industry, including support mechanisms. Car prices and demand will largely depend on a looming increase in recycling fees and government subsidies for car makers to compensate them for investments in localization projects.

5. Despite the elimination of reduced interest rates on auto loans in 2018, car sales on credit remained in 2018 at levels similar to the previous year. This is due to the growing popularity of automakers’ captive finance. However, loan costs may increase further due to inflation and an anticipated increase in the key rate of the Central Bank of Russia in the first half of 2019. This could reduce car sales on credit.

6. Dealership networks continue to adapt to post-crisis changes in the market. Many underperformers have left the market, while others are going through financial restructuring programs. The 2017-18 recovery of the market has changed little for dealership networks. Their numbers are still excessive given the current size of the market. To retain their market share and maintain profit margins in the face of tight competition, dealers need to transform business models and focus on additional offers such as pre-owned cars, financial products, and digital to drive automotive content and online sales.

7. Truck sales grew at a considerably slower pace in 2018 due to the completion of some large-scale infrastructure projects and the satisfaction of pent-up demand.

8. The bus segment continued to be dominated by Russian brands. The production of new buses increased marginally compared with 2017. The ageing car park and tightening environmental requirements will drive the market in the medium run.

9. In early 2019, the Russian government announced its decision to keep in place some demand stimulation programs with a total budget of RUB 10 billion. This is significantly lower than the previous year’s RUB 44.5 billion budget earmarked to subsidize vehicle procurement by local governmental agencies, companies’ expenses for the repayment of investment loans, interest rates on car loans and leases, small and medium-sized business support programs (My Business, Russian Farmer and Russian Hauler) and programs such as Family Car and My First Car. Thus, the government has scaled down its support for consumption growth.

10. Automotive markets also continued to recover in Kazakhstan, Belarus and Uzbekistan in 2018 on the back of stronger economies and improving macroeconomic factors. Sales of newly made cars dropped in Ukraine, primarily due to increased imports of pre-owned vehicles after import duty on such cars from the European Union was lowered.
Russia’s economy

Russia’s economy grew for the third year in a row after a recession in 2015. GDP rose by 2.0% in 2018, accompanied by an increase in real wages and consumer lending. However, inflationary pressure on the national economy heightened amid a weaker Russian ruble and may increase further in 2019. As the VAT rate is raised to 20%, inflation is expected to accelerate from 3.0% in 2018 to 5.0% in 2019.

The construction industry demonstrated the highest growth rate, at 5.3%, in 2018 after a 1.2% decline a year earlier. The manufacturing, transportation and retail industries were also top contributors to GDP, showing growth rates of 2.9%, 2.9% and 2.6%, respectively. The agricultural industry performed slightly worse than a year earlier, with a reduction in the yield of grain crops and livestock production.

To improve the investment climate, the government should focus on creating favorable conditions for new investment projects, improving the regulatory framework, strengthening institutions and reducing government involvement in the economy.

Russia’s longer-term economic growth and investment appeal will depend on measures to diversify the economy by reducing the share of the extraction industry, develop civil society institutions and improve the well-being of the population.

Consensus forecast of nominal and real GDP growth in Russia

Sources: Oxford Economics, World Bank, CEEMEA, Ministry for Economic Development, IMF, EY analysis

* F – forecast
### Projected key macroeconomic indicators

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<td>Population. million</td>
<td>143.0</td>
<td>143.3</td>
<td>143.7</td>
<td>146.3</td>
<td>146.5</td>
<td>146.8</td>
<td>146.8</td>
<td>146.7</td>
<td>146.7</td>
</tr>
<tr>
<td>Real GDP growth. %</td>
<td>3.7%</td>
<td>1.8%</td>
<td>0.7%</td>
<td>-2.5%</td>
<td>0.3%</td>
<td>1.6%</td>
<td>2.0%</td>
<td>1.4%</td>
<td>1.7%</td>
</tr>
<tr>
<td>Inflation (average annual). %</td>
<td>5.1%</td>
<td>6.8%</td>
<td>7.8%</td>
<td>15.5%</td>
<td>7.1%</td>
<td>3.7%</td>
<td>3.0%</td>
<td>5.0%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Industrial Production Index. %</td>
<td>3.4%</td>
<td>0.4%</td>
<td>1.7%</td>
<td>3.4%</td>
<td>1.3%</td>
<td>1.0%</td>
<td>2.9%</td>
<td>1.6%</td>
<td>1.4%</td>
</tr>
<tr>
<td>Brent crude oil price. USD per barrel</td>
<td>112.0</td>
<td>108.9</td>
<td>98.9</td>
<td>52.7</td>
<td>44.1</td>
<td>54.3</td>
<td>71.2</td>
<td>65.5</td>
<td>66.1</td>
</tr>
<tr>
<td>Unemployment rate among the economically active population (annual average). %</td>
<td>5.5%</td>
<td>5.5%</td>
<td>5.2%</td>
<td>5.6%</td>
<td>5.9%</td>
<td>5.3%</td>
<td>4.8%</td>
<td>4.7%</td>
<td>4.6%</td>
</tr>
<tr>
<td>RUB/USD exchange rate (annual average)</td>
<td>30.8</td>
<td>31.8</td>
<td>38.4</td>
<td>60.9</td>
<td>66.8</td>
<td>58.3</td>
<td>62.9</td>
<td>65.5</td>
<td>65.5</td>
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<tr>
<td>RUB/EUR exchange rate (annual average)</td>
<td>39.6</td>
<td>42.3</td>
<td>51.0</td>
<td>67.5</td>
<td>74.1</td>
<td>66.0</td>
<td>74.1</td>
<td>77.1</td>
<td>79.3</td>
</tr>
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</table>

Sources: BMI, EIU, Oxford Economics EIA, Bloomberg, Federal Statistics Service, MED, EY analysis, CEEMEA, Development Center of the Higher School of Economics

* F – forecast
Current trends in the global automotive market

Global sales of passenger cars and LCVs dropped by 0.4% to 94.9 million vehicles in 2018 after eight years of steady growth.

The decline can be attributed to the following factors:

- Decreasing sales in the Asian market, primarily in China, where they were down 3.0%;
- A steady decline in sales in North America (Mexico and Canada);
- Slower growth in sales in Europe due to uncertainty around Brexit;
- A sharp fall in sales in the Middle East due to shrinking demand in Iran, Turkey and Saudi Arabia, the three biggest markets.

Growth is observed primarily in BRICS countries. After a fall to record lows two years earlier, the Brazilian and Russian markets began to recover in 2018, with sales increasing by 14.9% and 12.8%, respectively. Organic growth continued in the Indian market, where sales rose by 8.3%.

Asia remained the largest market, accounting for 46.6% of sales worldwide in 2018. The 2018 drop in sales in China was partially due to an anticipated tax cut in the second half of 2018, prompting consumers to delay car purchases. Tighter environmental standards and a trade war with the US, China’s largest trading partner, also contributed to the decline.

Despite growing sales, the year 2018 was challenging for the Indian automotive market due to the devaluation of the national currency, rising gasoline prices and the introduction of mandatory three-year insurance for new buyers. However, demand for cars is on the rise, driven by the stronger economy and low car penetration, with India having only 39 cars per 1,000 adults compared to 642 in Western Europe.
Japan’s automotive market grew by 1.2% thanks to increased household income amid stable macroeconomic fundamentals.

North America ranked second in car sales among regions, with the US accounting for 83.4% of total sales. The US market demonstrated insignificant growth, at 0.3%, in 2018, and sales dropped in Canada and Mexico. The performance of the US and Canadian markets primarily depended on car park renewal cycles. The Mexican market was under pressure from accelerated inflation and increased loan costs.

The EU and the UK ranked third in car sales, but key markets in the region showed a mixed performance: sales increased by 0.8% in Germany, by 3.8% in France and by 7.1% in Spain while falling by 3.4% in Italy and by 5.4% in the UK. The market growth in Germany, France and Spain was driven by stronger consumer confidence, while the Italian market contracted due to lower economic activity and slower economic growth. The continued uncertainty around Brexit negatively affected the UK market.

A considerable drop in sales was observed in key markets in the Middle East in 2018, with sales plunging by 34.4% in Turkey, by 21.5% in Saudi Arabia and by 20% in Iran. The rapid depreciation of the Turkish lira and increased loan costs were the main factors affecting the car market in Turkey. The Iranian market was under pressure from US sanctions, while the Saudi Arabian market was driven down by the introduction of 5% VAT and oil price volatility.

Global truck sales climbed by 4.3% year-on-year to 3.7 million vehicles in 2018. They were largely driven by sales growth in the US (+16.8%) and India (+24.9%). China was the largest consumer of trucks, accounting for 41% of total sales. After impressive growth at 32.4% in 2017, the Chinese market contracted by 0.9% in 2018 due to reduced demand from the construction industry. The performance of the US market was closely linked to macroeconomic fundamentals, with its growth in 2018 reflecting vibrant economy. The sales growth in India can be attributed to heavier investments in the construction industry, the development of the transport infrastructure and the recovery of mining activity.
Automotive market outlook

US disputes with key trading partners, the EU and China, along with slowdown in global economic growth, are key barriers to the growth of the car market in the short run.
Global sales of passenger cars and LCVs are projected to increase by a marginal 0.9% year-on-year to 95.7 million in 2019. India and Brazil are expected to demonstrate the highest growth rates, 7%-9% and 10%, respectively. Other Asian markets are not expected to grow by more than 2%.

At the same time, sales in North America are forecast to decline by 1.5% as the US administration has called for tariffs on car imports as part of protectionist measures.

There is limited potential for growth in passenger car sales in the EU due to high car penetration. The continued uncertainty around Brexit is another restraining factor. Car sales in Europe are projected to remain at the previous year's level despite a bright outlook for economic growth.

Global truck sales are to decline by 3.3% to 3.6 million in 2019. The market will be affected by a 15% fall in demand in China due to the sluggish economy and a sales boom in the previous two years.

BRICS countries and other developing markets with low car penetration will be the key contributors to global car sales, projected to account for 92% of sales growth between now and 2025.
Future growth in car sales in developing countries is conditional on the development of the necessary infrastructure to maintain the increasing car park. Much will depend on the speed of car park renewal and market transformation associated with a shift from car purchases to the purchase of mobility services, the rise of electric vehicles, digitalization and the increasing popularity of car sharing.

Sales of electric vehicles will be driven by the dropping cost of batteries, tightening environmental policies and government support. Over the next decade China, Europe and the US will become the key sales markets in this segment.

Digital technologies have only recently started to transform consumer experiences in the automotive industry. Increasingly more people are selecting cars online and are ready to buy one without visiting the dealership. The more digital consumers get, the more they value the convenience of purchasing experience, including the possibility of configuring the car and placing an order online, as well as wider variety and availability of additional options.

Car sharing is growing in popularity despite the fact that many still prefer personal vehicles. The growth of car sharing is observed primarily in big cities, allowing their inhabitants to save time and money on transportation.
This trend is driven by technology advancements that have led to the emergence of a variety of mobility apps such as Gett Taxi, Bla Bla Car and Truvolo. The global car sharing market is projected to grow by an average of 25% annually and reach US$620 billion in 2025.

Top international car makers are now heavily investing in the development of self-driving technology. However, this trend is unlikely to disrupt the automotive market in the next decade. A lack of proper infrastructure, regulatory uncertainty, engineering challenges and high costs are the key hurdles that self-driving cars face.

### Key drivers of digital car sales

- **>95%**
  Of consumers research cars online

- **~80%**
  Of consumers say that online videos influence their choice of a car model

- **>40%**
  Of consumers highlight the importance of independent data on cars

### Key car sharing drivers and indicators in Western countries

- **~55%**
  Of car owners highlight the importance of services that enable fast transportation

- **~25%**
  Of consumers are ready to consider car sharing versus ownership

- **10-20%**
  Of household spending is on owning and operating personal cars

- **$48.6 bln**
  Has been invested in the development of mobility technology in the last five years

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**Penetration of digital passenger car sales in Eastern Europe**

- **>50%**
  Receive online offers
- **30-40%**
  Ready to buy online in the near future
- **8-10%**
  Ready to buy online today

*Source: EY analysis in 2018*
Russia in the context of the global automotive industry

Russia’s market of passenger cars and LCVs continued to recover in 2018 against the backdrop of increased economic activity, with sales totaling 1.8 million vehicles.

Sales increased by 20.0% year-on-year in the first five months of 2018 to slow down later due to a worsening macroeconomic situation, with growth declining to 5.6%-11.0%. Average annual growth totaled 12.8% in 2018, only slightly up from 11.9% in the previous year.

Despite oil price fluctuations and accelerating inflation at the end of the year, market recovery continued thanks to pent-up demand, government incentives that remained in place under some programs and measures to increase car lending. Another contributing factor included an anticipated rise in the VAT rate and car prices in 2019, as well as fears of new economic restrictions.

Russia ranked 11th globally and fifth among European countries by volume of sales in 2018. Compared with Western countries, Russia’s automotive market has significant potential, primarily due to low car penetration and ageing car park.
There were 371 passenger cars per 1,000 adults in Russia in 2018, which is significantly lower than in Western Europe (642 cars) and North America (928 cars). The average age of passenger cars and LCVs in Russia exceeded 13 years in 2018, compared with nine years in Western Europe. Car sales on credit increased in Russia in 2018, making up 48% of total sales. However, Russia fares worse on this indicator as well compared with West European countries, where two out of every three cars are bought on credit on average.

The weakness of the Russian ruble is among the factors putting the brakes on market recovery. Car manufacturers have to raise their prices to make up for increased expenses on imported auto parts that comprise a substantial portion of car costs. Car prices jumped by 7.5% in 2018, more than double the inflation rate.

Foreign car makers continue, however, to invest in business development in Russia, a sign of the domestic industry’s great potential. Mercedes-Benz and Haval completed the construction of their car assembly plants in Russia in 2018, preparing to begin mass production in 2019. A number of companies unveiled plans to produce engines and gearboxes locally in Russia.

Russia’s Export Development Strategy, adopted in 2017 to boost exports, may become an important driver of sales amid tepid economic growth and the satisfaction of pent-up demand.

In 2018, the Russian government continued to provide direct support to car manufacturers and subsidize interest rates on car loans under Family Car and My First Car and other programs to drive consumption.

Any further growth of Russia’s automotive industry is highly conditional on both economic and regulatory factors. Crucial economic factors include external market forces, fluctuations in oil prices and the Russian ruble and the possible introduction of new economic restrictions. Among regulatory risks are the government’s plans to raise national utilization fees and the absence of a transparent subsidy mechanism to compensate car makers and suppliers for investments in localization projects and higher import duty after the end of the industrial assembly regime.
Passenger car and light commercial vehicle (LCV) market

According to the AEB, sales of passenger and LCVs climbed to 1,801,000 vehicles in 2018, up 12.8% from the previous year’s level. Sluggish growth in the second half of 2018, attributed to a worse macroeconomic situation, continued into January 2019 when sales rose only by 0.6% year-on-year to drop by 3.6% in February.

Passenger car sales grew three times faster than LCV sales (13.6% versus 4.6%), which declined by 7% year-on-year in the fourth quarter of 2018. Given the current macroeconomic risks, small and medium-sized businesses are delaying the renewal of their car parks. The rising cost of loans put more pressure on the market in the second half of 2018.

A decline in LCV sales in Russia may signal a looming fall in sales of passenger cars, as these typically follow the same pattern as the LCV market, but with a time lag. The beginning of 2019 has reinforced such fears as sales increased by only 0.6% year-on-year in January to plunge by 3.6% in February.

The share of imports gradually declined for several consecutive years until 2017 to stabilize at 17% of total sales in 2018, the same level as in the previous year. However, the trend may reverse if...
consumers regain confidence and see their real household disposable income increase.

LADA, Kia, Hyundai and Renault remain the leading car brands in Russia’s passenger car market, accounting for more than half of sales. Market consolidation continues as top manufacturers of mass-market cars that have channeled the heaviest investments into localization projects want to strengthen their foothold. Contributing factors include a broad product line, including in the fast-growing SUV segment, affordable ownership costs and the concentration of government support on projects to manufacture mass-market cars with a high local content. Russia’s top-selling brands in 2018 were LADA Vesta (6.5% of total sales of passenger cars), LADA Granta (6.4%), KIA Rio (6.0%), Hyundai Creta (4.1%) and Hyundai Solaris (3.9%).

Sales of passenger cars and LCVs in Russia by origin, %

- **2015**
  - Russian makes: 55%
  - Imported foreign makes: 23%
  - Locally made foreign makes: 22%

- **2016**
  - Russian makes: 55%
  - Imported foreign makes: 19%
  - Locally made foreign makes: 26%

- **2017**
  - Russian makes: 57%
  - Imported foreign makes: 26%
  - Locally made foreign makes: 17%

- **2018**
  - Russian makes: 57%
  - Imported foreign makes: 17%
  - Locally made foreign makes: 26%

Sources: AEB, Russia’s Federal Customs Service, EY analysis
Despite growing premium brand sales that increased from 9,500 to 146,900 passenger cars, their share in total sales dropped for the second year in a row as consumer demand shifted to cheaper brands. Sales of mass-market brands are also recovering more quickly than sales of premium brands because they previously dropped at a faster rate. The share of premium brands is projected to grow in the longer run on the back of increasing household earnings to close the gap with Western countries, where their share totals around 20%.

The production of cars and capacity utilization in the automotive industry picked up in 2017-18 as consumer demand rebounded. The government’s export growth strategy, adopted for the automotive industry in 2017, was also a contributing factor. Exports jumped by 11% year-on-year to US$3.4 billion in 2018, surpassing the target set under the strategy by 19%-28%. Exports of auto parts became a key contributor (+26.1%).

Breakdown of major passenger car makes in Russia, %

<table>
<thead>
<tr>
<th>Year</th>
<th>LADA</th>
<th>Kia</th>
<th>Hyundai</th>
<th>Toyota</th>
<th>Renault</th>
<th>Nissan</th>
<th>Volkswagen</th>
<th>Ford</th>
<th>Other</th>
</tr>
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<tbody>
<tr>
<td>2015</td>
<td>29%</td>
<td>2%</td>
<td>5%</td>
<td>6%</td>
<td>6%</td>
<td>8%</td>
<td>11%</td>
<td>11%</td>
<td>11%</td>
</tr>
<tr>
<td>2016</td>
<td>24%</td>
<td>3%</td>
<td>4%</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>11%</td>
<td>11%</td>
<td>11%</td>
</tr>
<tr>
<td>2017</td>
<td>22%</td>
<td>3%</td>
<td>4%</td>
<td>5%</td>
<td>6%</td>
<td>6%</td>
<td>11%</td>
<td>11%</td>
<td>11%</td>
</tr>
<tr>
<td>2018</td>
<td>21%</td>
<td>2%</td>
<td>5%</td>
<td>6%</td>
<td>6%</td>
<td>9%</td>
<td>11%</td>
<td>11%</td>
<td>14%</td>
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Share of premium models in total sales

<table>
<thead>
<tr>
<th>Year</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
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<tr>
<td>2012</td>
<td>7%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
<td>10%</td>
<td>9%</td>
<td>8%</td>
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<tr>
<td>2013</td>
<td>7%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
<td>10%</td>
<td>9%</td>
<td>8%</td>
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<tr>
<td>2014</td>
<td>7%</td>
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<td>8%</td>
<td>9%</td>
<td>10%</td>
<td>9%</td>
<td>8%</td>
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<td>2015</td>
<td>7%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
<td>10%</td>
<td>9%</td>
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<tr>
<td>2016</td>
<td>7%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
<td>10%</td>
<td>9%</td>
<td>8%</td>
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<tr>
<td>2017</td>
<td>7%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
<td>10%</td>
<td>9%</td>
<td>8%</td>
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<tr>
<td>2018</td>
<td>7%</td>
<td>7%</td>
<td>8%</td>
<td>9%</td>
<td>10%</td>
<td>9%</td>
<td>8%</td>
</tr>
</tbody>
</table>

Sources: LMC Automotive, AEB, EY analysis
The Taganrog Auto Plant with an annual capacity of 120,000 vehicles closed in 2018. In 2019, the Derways Automobile Company closed its Cherkessk-based plant that made the Chery and Lifan brands*. The plant’s annual capacity was 130,000 vehicles.

At the same time, many auto makers commenced or completed the construction of new plants in 2018**:

- **Haval** completed the construction of a 150,000-unit car plant in the Tula region in August 2018. The plant will operate pressing, welding, painting, assembly and auto parts production lines. Its commencement is scheduled for 2019.

- **Mercedes-Benz** has completed the construction of a plant with an annual capacity of 20,000 passenger cars in the Moscow region. The facility will be commissioned in 2019.

- **Mazda Sollers** opened a car engine plant in Vladivostok in September 2018. The plant has an annual capacity of 50,000 engines. The company has also unveiled plans to implement more investment projects.

- **Sollers-Isuzu** plans to build a medium-duty truck assembly plant with a 7,000-vehicle annual capacity in the Ulyanovsk region under a Special Investment Contract. The mass production of trucks is scheduled to begin in 2021.

- **Unison** has obtained approval from the Federal Antimonopoly Service to buy General Motors’ plant in St. Petersburg. The company intends to resume the production of Chinese and other brands at the plant mothballed a few years ago. The plant has an annual capacity of 98,000 vehicles.

- **The Belarusian-Chinese company BelGee** began to assemble Geely cars in Belarus in 2018. The plant can make 60,000 vehicles annually. The company plans to assemble 25,000 cars in 2019 and export 70% of them to Russia.

### Government support for demand

In early 2019, the Russian government announced its decision to keep in place some demand stimulation programs with a total budget of RUB 10 billion. This is significantly lower than the previous year’s RUB 44.5 billion budget earmarked to subsidize vehicle procurement by local governmental agencies, companies’ expenses for the repayment of investment loans, interest rates on car loans and leases, small and medium-sized business support programs (My Business, Russian Farmer and Russian Hauler) and programs such as Family Car and My First Car. Thus, the government has scaled down its support for consumption growth.

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** https://www.autostat.ru/news/36240/
https://www.vedomosti.ru/auto/articles/2019/01/14/791377-zavod-gm
Automotive market outlook

We expect the Russian market of passenger cars and LCVs to remain in recovery mode in 2019, but growth will slow down, to 5% under a baseline scenario. Our forecast was based on a moderately conservative outlook for economic growth free of macroeconomic shocks from risks such as a significant weakening of the Russian ruble or a plunge in oil prices. The forecast, however, took into account positive effects from pent-up demand that remains partly unsatisfied and additional cyclical demand that should be driven by the ageing of cars bought during the previous peak sales in 2012. Restraining factors that were considered included a risk of reduced government support under demand stimulation programs and the scheduled increase in the VAT rate from 18% to 20% on 1 January 2019.

The number of passenger cars registered by end-buyers in 2018 was comparable to the number of cars shipped to dealers, and this trend is expected to continue.

Russia’s car park totalled 47.5 million passenger cars and LCVs as of the end of 2018, up 3.0% from the previous year. Given Russia’s significant gap with Western countries in car penetration, the car park should continue to increase.

The market of pre-owned passenger cars rose by 2.4% to 5.43 million in 2018. Sales grew for the third year in a row but are still below the record level seen in 2014 when 6.10 million cars were sold in this market.

Sales grew more slowly than the market of new cars because their drop during the crisis was less significant (-20% in 2015). LADA remained an absolute leader in sales of pre-owned cars in 2018, accounting for more than 25% of such transactions. Trailing behind were Japanese and South Korean brands, including Toyota (11%), Nissan (6%), Hyundai (5%) and KIA (4%). However, sales of LADA cars in this market declined compared with other brands in the top ten that saw growth in sales. This trend may continue as older LADA models leave the market.

Actual and projected sales volumes of passenger cars and LCVs in Russia

Park of passenger cars and LCVs in Russia in 2012-21
Truck market*

The truck market grew by only 2.7% in 2018 compared with 50.8% a year earlier, which was due to the satisfaction of pent-up demand and the completion of large-scale infrastructure projects.

The growth was observed against the backdrop of improving macroeconomic fundamentals:

- Road carriage increased by 4.6% in 2018;
- Retail trade climbed by 2.6%;
- Capital investments rose by 4.1% in the first nine months of 2018.

Amid a high 2017 base and with a number of major infrastructure projects at or near completion, including the construction of 2018 FIFA World Cup facilities, the Crimean Bridge Project and the Power of Siberia Project, the growth was slow.

Thanks to increased business activity in 2017-18, consumer demand shifted to more expensive foreign models. Nonetheless, KAMAZ and GAZ brands continued to hold the largest and second-largest market shares, respectively.

* A motor vehicle with a fully loaded weight of over 3.5 tons that is designed for freight transportation, with the exception of models classified as LCVs.
Demand for trucks grew more quickly in January 2019 compared with the first month of 2018, at 6.6%. Sales of new trucks declined by 5.1% year-on-year in February 2019 and are expected to demonstrate moderate growth throughout the year, at 5%. Contributing factors will be continued economic recovery and the ageing car park.

Two out of every three trucks in Russia were more than 10 years of age in 2018. Trucks aged under five years and from five to 10 years account for 17% and 16% of the car park, respectively. Demand, however, may be lower than expected due to risks such as an anticipated increase in utilization fees and rising prices of fuels and lubricants.

Large-scale investment projects under Public Private Partnership may give a boost to demand in the medium run. According to the government’s plans, expenditures on infrastructure projects are expected to total RUB 6.3 trillion between now and 2024.

**Russia’s truck market structure by make***

<table>
<thead>
<tr>
<th>Year</th>
<th>KAMAZ</th>
<th>GAZ</th>
<th>Scania</th>
<th>MAN</th>
<th>Volvo</th>
<th>Mercedes-Benz</th>
<th>MAZ</th>
<th>ISUZU</th>
<th>UralAZ</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>34%</td>
<td>5%</td>
<td>5%</td>
<td>7%</td>
<td>4%</td>
<td>2%</td>
<td>5%</td>
<td>14%</td>
<td>4%</td>
<td>5%</td>
</tr>
<tr>
<td>2016</td>
<td>38%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>4%</td>
<td>5%</td>
<td>14%</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>2017</td>
<td>33%</td>
<td>5%</td>
<td>5%</td>
<td>7%</td>
<td>6%</td>
<td>7%</td>
<td>7%</td>
<td>10%</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>2018</td>
<td>31%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>6%</td>
<td>8%</td>
<td>8%</td>
<td>10%</td>
<td>6%</td>
<td>4%</td>
</tr>
</tbody>
</table>

* Based on registration data for non-military trucks

Sources: AUTOSTAT analytic agency, EY analysis
Bus market

Bus sales largely depend on how much cash local bus operators – the key consumers – have available.

Passenger carriers and big manufacturing companies also drive consumption. However, key market players were forced to delay the renewal of their bus parks during the crisis to revisit the matter after the macroeconomic situation stabilized. The production of buses increased to 43,000-48,000 in 2016-18, compared with 37,000 in 2015.

There was additional demand for buses due to the FIFA 2018 World Cup in Russia. In 2018, the government also continued to support bus manufacturers - 1,327 buses were bought for schools under a federal program. Bus park renewal programs run in big cities also contributed to sales. As many as 1,110 new buses were added to Moscow’s bus park.

Bus production trends in Russia

Government support is primarily focused on domestic brands, whose share has been consistently large. However, Chinese manufacturers strengthened their foothold in 2018, increasing their exports to Russia thanks to competitive prices. European brands saw their market share decline due to high prices. Tightening environmental standards, the need for park renewal and the rise of sharing economy are expected to transform the market in larger cities in the medium run. The average age of Russia’s bus park was 15 years in 2018, with more than 45% of buses being far older.
Ninety percent of buses today run on engines under the Euro 4 emission standard.

There is also gradual growth in electric bus adoption in public transportation. In 2018, the Moscow government bought its first electric buses, and it plans to buy 800 every year for the city to operate an electric bus park of 1,800 units by the end of 2023.

**Bus sales in Russia**

<table>
<thead>
<tr>
<th>Year</th>
<th>Russian makes</th>
<th>Localized foreign makes</th>
<th>Imported foreign makes</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>21%</td>
<td>74%</td>
<td>5%</td>
</tr>
<tr>
<td>2016</td>
<td>22%</td>
<td>73%</td>
<td>5%</td>
</tr>
<tr>
<td>2017</td>
<td>25%</td>
<td>69%</td>
<td>6%</td>
</tr>
<tr>
<td>2018</td>
<td>22%</td>
<td>69%</td>
<td>9%</td>
</tr>
</tbody>
</table>

*Sources: Association of Russian Automakers Nonprofit Partnership, EY analysis*
Dealership networks

Dealership networks continue to adapt to post-crisis changes in the market. Many underperformers have already left the market, while others are undergoing financial restructuring. The 2017-18 recovery of the market has changed little for dealership networks. Their number is still excessive and some may be pushed out of the market.

To retain their market share and maintain profit margins in the face of intense competition and lower profits on new cars, dealers need to transform business models and focus on the extension of their offers with pre-owned cars, financial products, and on digital to drive automotive content and online sales.

The pre-owned vehicle market has great potential to unlock. The share of pre-owned vehicles sold through dealership networks is around 15% in Russia versus 50% in West European countries, while profit margins in this market can reach 8%-10% compared with zero profit often earned on sales of new vehicles. VAT and other tax rules need to be revised to give a boost to sales of pre-owned cars. A spearhead group consisting of the Russian Association of Automobile Dealers and EY experts has proposed legislative amendments to enhance the legal framework.

Comparison of the number of dealerships and sales of passenger cars and LCVs in Russia

Sources: AUTOSTAT analytic agency, AEB, EY analysis

To improve marketing efficiency and value per client, it is important to adopt a multichannel sales strategy to sell both offline and online. Many players have already started to invest in IT solutions. Such strategies help increase customer loyalty and cut operating costs amid tight competition.

Value can also be created from telematics solutions and car data.
Auto loan market

The share of car sales on credit nearly recovered to its historical high, half of total sales, in 2017-18, which can be attributed to subsidized interest on car loans offered under a government program during a crisis.
Despite an increase in interest rates on car loans following the elimination of subsidies in January 2018, sales on credit remained at a level similar to the previous year. Contributing factors included the fast growth of captive banks and support under programs such as My First Car and Family Car in the first half of 2018.

Major banks continue to dominate the car lending market, accounting for more than 70% of it. At the same time, the number of auto manufacturers setting up captive banks is also on the rise. The market share of captive banks rose from 15% in 2014 to 28% in 2018 and is projected to grow further, given their much bigger share in Western countries (75%). Captive banks help auto manufacturers:

- Maintain and expand market presence by offering subsidized loans;
- Improve revenues and profits by bundling products and offering after-sales services;
- Increase brand loyalty by offering complex solutions on one platform.

Best international practices suggest that loans subsidized by auto makers via captive banks are a more efficient tool for improving customer loyalty, stimulating repeat purchase behavior and increasing value per client, compared with subsidizing dealers directly.
In 2018, banks offered more loans to consumers for purchases of pre-owned vehicles. Their number rose by 45% to 23% of total car loans, primarily due to increased sales of used cars via dealership networks and increased share of cars under five years of age in the total car park.

The proportion of car sales on credit varies by region and depends to a large extent on household disposable income. Such sales accounted for only 27.2% of total sales in Moscow in 2018 versus 69.4% in Perm Krai.

However, sales of passenger cars on credit may increase in the medium run, given Russia’s gap with Western countries where they make up 65% to 70% of total sales. This trend will intensify with the emergence of new captive banks.

Major barriers to growth in car loans include:

- Inflation acceleration and an anticipated increase in the key interest rate of the Central Bank of Russia in the first half of 2019 that can drive loan costs;
- Unfavorable taxation rules for auto leases by individuals, including the double imposition of VAT that makes car leases much more expensive than car loans.

### Share of automotive credit sales by region in 2018 (%)

<table>
<thead>
<tr>
<th>Region</th>
<th>New car credit sales, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perm Krai</td>
<td>69.4%</td>
</tr>
<tr>
<td>Bashkortostan</td>
<td>66.4%</td>
</tr>
<tr>
<td>Chelyabinsk region</td>
<td>63.1%</td>
</tr>
<tr>
<td>Republic of Tatarstan</td>
<td>61.1%</td>
</tr>
<tr>
<td>Nizhny Novgorod region</td>
<td>59.2%</td>
</tr>
<tr>
<td>Sverdlovsk region</td>
<td>56.7%</td>
</tr>
<tr>
<td>Rostov region</td>
<td>51.6%</td>
</tr>
<tr>
<td>St. Petersburg</td>
<td>46.3%</td>
</tr>
<tr>
<td>Moscow region</td>
<td>35.8%</td>
</tr>
<tr>
<td>Moscow</td>
<td>27.2%</td>
</tr>
</tbody>
</table>

**Sources:** National Bureau of Credit Histories, EY analysis

### Key players on the auto loan market in the first half of 2018

**Sources:** Frank Research Group, Central Bank of Russia, EY analysis
CIS automotive markets

The economies of Ukraine, Kazakhstan, Belarus and Uzbekistan demonstrated growth in 2018 as macroeconomic fundamentals stabilized.
The automotive markets in these economies showed a mixed performance in 2018, growing in Kazakhstan, Belarus and Uzbekistan thanks to pent-up demand and higher consumer buying power. In Ukraine, demand for new vehicles dropped after a cut in import duty on used cars from the European Union. A total of 344,000 vehicles were sold in the four markets in 2018, up 27% from the 2017 level. Car production climbed by 40% to 230,000 vehicles.

Kazakhstan

Kazakhstan’s market of passenger cars and LCVs grew at a faster pace in 2018, at 25% versus 7% a year earlier. A total of 57,900 cars were sold. Kazakhstan’s economy lagged behind Russia’s in recovery, with consumers rushing to buy cars only in 2018.

Budget car brands continued to dominate the market. LADA ranked first in sales in 2018, accounting for more than 23% of total sales. Trailing behind were Toyota, Hyundai and KIA with 21%, 15% and 5%, respectively.

Car production in Kazakhstan grew for the second year in a row to reach 31,100 vehicles in 2018, 14,000 up from the previous year. The 2018 figure was comparable with that seen in the pre-crisis year of 2014, when 37,800 cars were made, while sales of locally produced cars for the first time ever exceeded 50% of total sales. LADA was the best-selling brand among locally assembled passenger cars in 2018, with 13,100 LADA cars sold. Hyundai and KIA ranked second and third with sales of 8,100 and 2,600 cars, respectively.

The Kazakhstan Business Association projects the local automotive market to grow by 15% to 20% in 2019. The growth will be driven by rising real household disposable income and subsidized car loans.

Movements in CIS currency exchange rates against the US dollar

Sources: Bloomberg, EY analysis
Belarus
Sales of passenger cars and LCVs rose by 54% year-on-year to 52,800 vehicles in Belarus in 2018. The growth was due to the stabilization of the Belarusian ruble and economic growth that prompted consumers to return to car purchases. The development of lending programs was also a contributing factor, making car loans more affordable and stimulating consumers to shift their focus away from the market of pre-owned cars.

Like in Kazakhstan, Belarusian consumers prefer cheaper brands. The most popular brands in the market in 2018 were Renault (with a market share of 21%), LADA (20%), Volkswagen (13%) and Geely (6%).

Car production increased from 3,600 vehicles in 2017 to 13,300 in 2018, mainly due to the beginning of mass production at the Chinese car manufacturer Geely’s plant. The Chinese manufacturers plan to make 25,000 cars in Belarus in 2019 and export 70% of them to Russia.

Uzbekistan
Sales of passenger cars and LCVs increased by 46% year-on-year to 147,800 vehicles in Uzbekistan in 2018. Pent-up demand accumulated in 2016-17 was the key driver. Locally assembled Chevrolet cars are the most popular brand. Sales of other brands are insignificant due to high import duty and excise tax, which effectively act as protective tariffs. Competition can come from LADA as cars made in the Customs Union are subject to reduced excise tax rates and exempt from customs duty. LADA sales are currently marginal, but they are growing at a fast pace. A total of 3,100 LADA cars were sold in 2018, more than triple the previous year’s level. Uzbekistan needs to lower import duty and excise tax on foreign cars and stimulate the local production of other brands in order to give a boost to its automotive market.

Uzbekistan made 180,200 cars in 2018, up 29% from 2017. General Motors Uzbekistan, which produces Chevrolet for the local market and Ravon for export to foreign markets, is the only large car manufacturer in Uzbekistan. Russia is the top destination for exports, but Ravon exports were suspended in the first half of 2018 after price hikes, with Ravon sales in Russia dropping from 15,100 in 2017 to 5,200 in 2018.
The company plans to resume exports to Russia in 2019. Uzbekistan’s automotive market can change after a landmark deal in which General Motors sold off its remaining stake in a joint venture to state-owned company Uzavtosanoat. Government’s stake increased from 75% to 100% as a result. The change of control does not mean the suspension of Uzbekistan’s cooperation with the US auto maker. The plant will continue to make Chevrolet and Ravon brands but will also be able to cooperate with other auto makers.

Sales of passenger cars and LCVs in selected CIS countries, units

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belarus</td>
<td>50,000</td>
<td>50,000</td>
<td>26,978</td>
<td>34,255</td>
<td>52,835</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>162,542</td>
<td>145,915</td>
<td>43,368</td>
<td>46,377</td>
<td>57,935</td>
</tr>
<tr>
<td>Ukraine</td>
<td>102,773</td>
<td>50,322</td>
<td>71,700</td>
<td>89,326</td>
<td>85,889</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>165,171</td>
<td>185,361</td>
<td>119,185</td>
<td>101,257</td>
<td>147,831</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>480,486</strong></td>
<td><strong>431,598</strong></td>
<td><strong>261,231</strong></td>
<td><strong>271,215</strong></td>
<td><strong>344,490</strong></td>
</tr>
</tbody>
</table>

Sources: LMC Automotive, AUTOSTAT analytic agency

Production of passenger cars and LCVs in CIS countries, units

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018 (Estimate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belarus</td>
<td>9,126</td>
<td>10,255</td>
<td>10,090</td>
<td>3579</td>
<td>13,266</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>37,782</td>
<td>12,453</td>
<td>10,289</td>
<td>17,109</td>
<td>31,064</td>
</tr>
<tr>
<td>Ukraine</td>
<td>26,262</td>
<td>5921</td>
<td>4517</td>
<td>7782</td>
<td>5792</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>248,828</td>
<td>185,400</td>
<td>88,152</td>
<td>140,247</td>
<td>180,238</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>321,998</strong></td>
<td><strong>214,029</strong></td>
<td><strong>113,048</strong></td>
<td><strong>164,451</strong></td>
<td><strong>230,360</strong></td>
</tr>
</tbody>
</table>

Sources: LMC Automotive, AUTOSTAT analytic agency
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* Auditor data as of January 2019
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Overview of the Russian and CIS automotive industry

March 2019
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